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RUEHLP/AMEMBASSY LA PAZ 4056
RUEHMN/AMEMBASSY MONTEVIDEO 5437
RUEHSG/AMEMBASSY SANTIAGO 5041
RUEHRG/AMCONSUL RECIFE 0123
RUEHRI/AMCONSUL RIO DE JANEIRO 1924
RUEHSO/AMCONSUL SAO PAULO 2826
RUEATRS/DEPT OF TREASURY WASHDC
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SIPDIS

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SOUTHCOM FOR POLAD AND J5 FOR JUAN RENTA
USDOC FOR 4322/MAC/OLAC/BASTIAN/PEACHER

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SUBJECT: TELECOMMUNICATIONS SECTOR UNDERGOES DRAMATIC
CONSOLIDATION

¶1. (U) Sensitive but unclassified, not for internet
distribution.

Summary

¶2. (U) Argentina's telecommunications industry has gone
through a great deal of change since its initial
liberalization in 1989. The consolidation following the
economic crisis in 2001-2002 has left the telecom industry
in the hands of three major multinational companies,
Telefonica, Telecom, and Telmex. Telefonica de Argentina
and Telecom de Argentina have withdrawn their ICSID
arbitration claims against the GOA. Nextel of the U.S. has
created a profitable mobile service niche for itself and is
the only US telecommunications company left in Argentina.
The GOA is trying to create a new telecom company, COMARCOP,
based on local cooperatives, but the company faces many
difficulties. End Summary.

Privatization and Expansion

¶3. (U) The Menem administration privatized the National
Telecommunications Company (ENTel) in 1989, leading to the
establishment of a duopoly between Telefonica and Telecom.
The privatization process divided the country into two
geographical areas. Telefonica of Spain controlled the
central to southern region of Argentina while Telecom of
France and Italy controlled the central to northern region.
The two companies invested an estimated USD 17 billion in
infrastructure and quality of service standards from 1991-
¶1999. BellSouth, a U.S. mobile service company, received
the licensing rights for Buenos Aires just prior to the
privatization of ENTel. Buenos Aires made up 80 percent of
the Argentine telecommunications market at the time and
mobile services were non-existent outside of Buenos Aires.

¶4. (U) The Menem administration opened the mobile services
market for the interior of the country in 1993 and further

deregulated the telecommunications industry in 1996, leading to further foreign investment in the telecommunications sector. Verizon, Nextel, AT&T, and Enron invested in both fixed landline and mobile services. Verizon began to invest in the interior of the country by setting up fixed land lines. Nextel began a nationwide mobile service directed at businesses and high-income individuals. AT&T invested in infrastructure, laying down fiber-optic networks and fixed land lines for business-to-business and international long distance phone calls. Enron invested in Transporters of Southern Gas (TGS) who owns the telecom company Telcosur. Telcosur invested in laying down a fiber optic network throughout Argentina. Fixed land line and mobile services have and still represent 80 percent of the telecommunications industry revenue, while infrastructure such as fiber optic networks represents the remaining 20 percent.

Crisis and Consolidation

¶5. (U) The economic crisis of 2001-2002 bankrupted many foreign telecom companies leading locally managed investment funds to purchase international companies below market value. US companies such as Verizon and Enron filed for bankruptcy and sold their assets below market value due to problems associated with a combination of peso revenues, dollar debt and a weakened consumer market. Telefonica bought BellSouth, Telecom purchased Verizon, and Telmex bought AT&T. Telecom majority owner France Telecom sold the majority of their holdings to the Werthein Group, an Argentine investment group, in 2003. France Telecom now

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owns just 2 percent of Telecom.

¶6. (U) Three major companies have emerged from the consolidation that followed the economic crisis of 2001-2002: Telefonica, Telecom and Telmex of Mexico. Telefonica is now the largest telecom company in Argentina with 4.3 million fixed land lines. Telefonica's mobile services subsidiary is Movistar which was acquired when Telefonica bought BellSouth. Telecom is the second largest telecom company in Argentina. Telecom owns the Personal mobile services company and the Arnet internet company. Telecom's exit from Argentina is expected to occur within the next few years as it has sold off all of its other Latin American assets outside of Brazil and Argentina, according to a local telecom executive. Telmex entered the Argentine market when it acquired AT&T in 2004. Telmex sister company America Moviles owns the CTI mobile services company. Telmex has been attempting to purchase Telecom but Telecom's asking price has been too high, according to the same local executive.

Resolution of ICSID Arbitration Claim

¶7. (U) Telefonica withdrew its USD 2.834 billion World Bank International Center for Settlement and Investment Disputes (ICSID) arbitration claim against the GOA in February 2006. In exchange for withdrawing its claim, Telefonica will now be able to double the cost of phone calls made during the hours from 8 p.m. to 9 p.m. Monday through Friday. Telefonica will also be able to dollarize charges on all incoming international phone calls, thereby tripling Telefonica's revenue on those calls. Telefonica, for their part, agreed to invest ARP one billion (USD 333 million) in ¶2006.

¶8. (U) Telecom Argentina likewise withdrew its USD 297.5 million ICSID arbitration claim against the GOA in February ¶2006. Telecom will also be able to dollarize incoming

international phone calls. Telecom has promised to reduce rates for residential phone calls. Telecom will start reducing long distance and international rates starting at 10 p.m. instead of 9 p.m., which is significant because a large percentage of private residential international phone calls occur during the hours of 9 p.m. to 10 p.m. Telecom has promised the GOA that it will invest ARP three billion pesos (USD 1 billion) in Argentina in the next three years.

¶9. (U) A lesser-known part of the GOA's agreement with Telefonica and Telecom was to not allow cable companies to provide triple play service, according to a local IT executive. Triple play service is the grouping of telephone, TV and data access into a single subscription on a broadband connection. The provision of triple play service on a broadband connection could undercut Telefonica and Telecom revenue, as recently occurred when a local cable company undercut Telefonica's telephone business in Chile. Thus, Telefonica and Telecom are believed to have dropped their ICSID arbitration claims in exchange for this type of protection.

Nextel Survival

¶10. (U) Nextel is the only U.S.-based telecom company that was able to survive the economic crisis of 2001-2002. Nextel did so by taking out a USD 100 million dollar loan to pay off its dollar debt, converting their US dollar receivables into peso receivables, and being flexible with the forms of payment from their hard-pressed customers (some customers were even allowed to pay their bills in devalued provincial quasi-currencies). Nextel also doubled the number of its customer service centers while other companies closed their centers. This combination of steps helped Nextel retain and

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acquire many new customers.

¶11. (U) Nextel went on to develop a profitable mobile services niche within the larger mobile services sector. Nextel captured Movicom customers when Telefonica purchased Movicom's parent company, BellSouth. Eighty percent of Nextel's client base is now small businesses and the remaining 20 percent is affluent individual consumers. Its strong customer service helps it compete with mobile services giants such as Movistar Personal and CTI. Nextel's average monthly billing is USD 40 compared to USD 13 for CTI. The difference in the size of Nextel's monthly billing is due to the fact that it has a customer base of small businesses and affluent individuals that are able to pay monthly bills while CTI has a customer base of lower income individuals that use prepaid phone service.

¶12. (U) Nextel's current business plan is defensive in the face of an uncertain telecommunications environment. Nextel is now only expanding its network servers in response to growth within its customer base. (Comment: Nextel Argentina is doing well but its parent company Sprint Nextel Inc. of the U.S. reported a 55 percent drop in fourth-quarter net income amid heavy merger-related expenses in 2005. End Comment.)

COMARCOP'S DIFFICULT BIRTH

¶13. (U) Secretary of Communications Guillermo Moreno has encouraged the establishment of a new Argentine wireless company, COMARCOP, to promote national industry and increase competition in the telecommunications sector. COMARCOP is composed of small Argentine telephone cooperatives located throughout the country. The GOA is planning to give COMARCOP the portion of the radio spectrum that Telefonica promised to return to the GOA after its acquisition of

BellSouth/Movicom. The initial start-up capital will come from a telecommunications fiduciary fund, which was also promoted by Secretary Moreno.

¶14. (SBU) COMARCOP faces a number of serious obstacles. The company is composed of inefficient Argentine telephone cooperatives which tend be poorly managed, are prone to corruption and fight among themselves. The one exception to this general statement is the telephone cooperative of Pinamar, which has a respectable reputation in the telecommunications sector. The Argentine telephone cooperatives also do not seem to understand the global telecommunications business well and the president of the organization, Anthony Picorini, has a bad reputation, both as a politician and a businessman, according to a local telecom executive. COMARCOP has approached a variety of international companies, including Nextel and Chinese telecommunications company Hutchinson, to help manage COMARCOP. Both companies turned down the offer, most likely due to their unwillingness to enter into a business that would be at least partially controlled by the Secretary of Communications.

Comment

¶15. (U) The telecommunications sector is likely to see less, rather than more, competition in the coming years. Competition is expected to decrease with Telmex's likely purchase of Telecom. The most promising potential source of increased competition, the introduction of triple play service, has been undercut by GOA's apparent agreement with Telefonica and Telecom. Finally, the Secretary of Communication's efforts to increase competition through the creation of COMARCOP is not likely to succeed given COMARCOP'S internal problems and Argentina's poor track record with the management of state-controlled enterprises.

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¶16. (U) To see more Buenos Aires reporting visit our classified website at:
<http://ww.state.gov/p/wha/buenosaires>

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